INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	4
Argument	5
Conclusion	9

CITATIONS

Cases:	
Brown v. *Helvering*, 291 U.S. 193	6
Burnet v. *Harmel*, 287 U.S. 103	5, 6, 7, 9
Burnet v. *Thompson Oil & Gas Co.*, 283 U.S. 301	6, 9
Helvering v. *Falk*, 281 U.S. 183	6, 8
Lynch v. *Alworth-Stephens Co.*, 267 U.S. 364	5
Murphy Oil Co. v. *Burnet*, 287 U.S. 299	6
Palmer v. *Bender*, 287 U.S. 551	6, 8
Reinecke v. *Spalding*, 280 U.S. 232	6
Statute:	
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 204 (U.S.C.App., Title 26, Sec. 935)	2
Miscellaneous:	
Treasury Regulations 69, Art. 216	3

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 176

WILLIAM E. HERRING, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 177

EULA DAY HERRING, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13–14) was a memorandum opinion, and not officially

reported. The opinions of the Circuit Court of Appeals (R. 37–46, 57–58) are reported in 70 F. (2d) 785 and 790.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on April 24, 1934. (R. 46, 58.) A petition for rehearing was denied June 8, 1934. (R. 53.) The petition for writs of certiorari was filed July 14, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was the partnership of C. T. Herring and Son, in which the two petitioners held an interest, entitled to deduct from its income for the year 1926 the statutory allowance for depletion in connection with cash bonuses received for the execution of oil and gas leases, even though there was no oil or gas produced from the property until after the close of the taxable year?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale

or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

(U.S.C.App., Title 26, Sec. 935.)

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 216. *Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

* * * * *

(e) In lieu of the treatment provided for in the above paragraphs the lessor of oil and gas wells may take as a depletion deduction in respect of any bonus, royalties, and other income from the property for the taxable year 27½ per cent of the amount thereof, but the deduction shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property.

STATEMENT

The facts of the case, as stipulated by the parties (R. 21–22) and as found by the Board of Tax Appeals (R. 13) may be summarized as follows:

The petitioners, who filed separate returns under the community property laws of the State of Texas, owned an interest, during the year 1926, in the partnership of C. T. Herrin and Son. The principal business of the partnership was cattle raising, and it owned several ranches in the vicinity of Amarillo, Texas. (R. 13, 21.) During the taxable year, it leased portions of its ranches to various individuals and corporations for the purpose of exploring for and producing oil and gas. (R. 21.) Under these leases, the partnership received, during the taxable year, bonuses aggregating $683,793.75. (R. 13, 22.) No oil development had been begun on any of the tracts at the date of leasing, and there was no oil well within three and one-half miles of the tract at that date. (R. 22.) No oil was produced from the properties during the tax-

able year, and there was no production whatsoever until 1930. (R. 13.) On the partnership return filed for the year 1926, depletion was taken of $188,043.28 against the bonus receipts, as representing the statutory allowance of 27½ per centum of the total amount received as bonuses during the taxable year. (R. 13, 22.)

This deduction was disallowed by the Commissioner, with the result that the petitioners' distributive share of the partnership's net income was increased, and a deficiency of $11,337.29 was determined against each of the petitioners. (R. 13–14.) The Board of Tax Appeals sustained the action of the Commissioner. (R. 14.) The Circuit Court of Appeals affirmed the decisions of the Board of Tax Appeals, Judge Sibley dissenting. (R. 46, 57.)

ARGUMENT

The statute permits a depletion deduction from gross income to account for the partial exhaustion of the mineral content of the land due to the production occurring within the taxable period during which the income was received. *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, 370.

The bonuses received by the partnership during 1926 in the instant case represented income to the petitioners for that year. *Burnet* v. *Harmel*, 287 U.S. 103. In seeking deductions for depletion in connection therewith, the burden was clearly upon the petitioners to show that they were entitled to

them. *Brown* v. *Helvering,* 291 U.S. 193, 199; *Reinecke* v. *Spalding,* 280 U.S. 227, 232.

Since it is stipulated that no oil was produced from the property during the taxable year (R. 22), the income received in the form of bonuses did not result from a reduction of the amount of oil contained, and consequently no deduction for depletion can be taken from the income. The actual exhaustion of oil content in later years must be deducted through depletion from the income received in those years. *Burnet* v. *Thompson Oil & Gas Co.,* 283 U.S. 301. Otherwise, the final determination of the tax necessarily would be postponed indefinitely in every case presenting this issue, until it was concluded whether the property would produce oil. Such a deferment is repugnant to the expressed intent of Congress, providing for the payment of tax on net income received during the preceding year.

The petitioners assert that the majority decision of the Circuit Court of Appeals is inconsistent with the decisions of this Court in the following cases (Br. 14): *Murphy Oil Co.* v. *Burnet,* 287 U.S. 299; *Burnet* v. *Harmel,* 287 U.S. 103; *Palmer* v. *Bender,* 287 U.S. 551; *Helvering* v. *Falk,* 291 U.S. 183.

Petitioners chiefly rely on *Murphy Oil Co.* v. *Burnet, supra.* From the opinion of the Circuit Court of Appeals in that case (55 F.(2d) 17 (C.C.A. 9th)), it is evident that there was oil production

from the properties during the years in which the bonus payments were made, which were prior to the taxable years, and that court expressly limited the depletion deduction to the actual amount of depletion sustained during the taxable years. This Court, in affirming that decision, did not propound any principle of which we are aware controverting our contention in the instant case.

The other three cases relied upon by the petitioners involved different questions from that in the instant case, and are manifestly not in point. In *Burnet* v. *Harmel, supra,* this Court said (p. 105):

> The only question presented here is whether the bonus payments to the respondent, after allowed deductions, if any, are "gain from the sale or exchange of capital assets" within the meaning of the taxing act.

It is true that this Court found that no distinction existed, as contended for, between a bonus and a royalty received by lessor and indicated that both were subject to depletion allowances. There is nothing in the opinion, however, to intimate that a depletion deduction should be allowed independent of and irrespective of actual production from the property. We are unable to determine from the record whether there was oil production from the property during the taxable years. That fact was not presented to the court and had no relation to the question at issue before it.

In *Palmer* v. *Bender, supra,* the petitioner, who was a member of two partnerships, sought to deduct depletion allowances in connection with bonus payments and royalties received by him through the partnerships. Both partnerships had conferred upon oil companies the rights which they possessed as lessees of certain properties in return for bonuses and royalties. The Commissioner contended that the depletion deductions were improper, since the transactions constituted assignments or sales of the leases, with no reversionary interests remaining in the partnerships. This Court held that the partnerships retained an economic interest in the oil in place, which was subject to depletion upon the production of the oil. Therefore, not only was the question involved in the case entirely different from that in the instant one, but this Court expressly found in its opinion (p. 553) that there was actual production on the properties during the taxable years involved. Obviously, then, that case does not support the petitioners' contention in the instant case.

The only remaining case cited by the petitioners in support of their contention is *Helvering* v. *Falk, supra.* That case presented the question as to whether the beneficiaries of a trust were entitled to deductions for depletion because of iron ore removed from the properties forming a part of the trust's corpus. Not only is the case, therefore, no authority for the petitioners, but also reference to

the findings of the Board of Tax Appeals (24 B.T.A. 299, 301), discloses substantial production of iron ore during each of the taxable years involved.

To sum up: In three of the cases cited by the petitioners, the record discloses actual production during the taxable years in question, whereas, in the instant case, it is stipulated that there was no production whatsoever. The fourth case, *Burnet* v. *Harmel, supra,* where the record fails to disclose whether there was production, is similar to the other three cases, in that the questions decided therein were manifestly different from the question here presented, and all four cases are, therefore, readily distinguishable. In fact, these cases tend to affirm the dependency of the depletion deduction upon the actual removal of the mineral content, as expressed in the statute itself.

With no production occurring in the instant case during the taxable year, and none until four years later, in 1930, we submit that the deduction for depletion claimed by the petitioners was not authorized by the statute or the regulations, and was, therefore, properly disallowed. *Burnet* v. *Thompson Oil & Gas Co., supra.*

CONCLUSION

It is submitted that the decision of the court below is in accordance with the law and the previous decisions of this Court. The decision is not in con-

flict with that of any other Circuit Court of Appeals. The petition should therefore be denied.

Respectfully submitted.

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